The growing threat of late payment to UK plc: A sector study

Introduction

Today, the issue of late payment of invoices is more acute than ever. The impact of payment delays on cashflow and capacity to expand order books, as well as the wider discussion around extended payment terms and poor payment practices, have for some time been a vital concern for all businesses. Now, as the UK faces the prospect of Brexit, with all the economic upheaval and uncertainty that entails, there's a very real risk that payment waiting times could become even longer as businesses look to consolidate their own cash-flow position at the expense of their suppliers

In doing so, the knock-on effect down the supply chain is likely to become more keenly felt. Invariably, it is the very smallest companies at the end of the chains which are worst hit and at most risk.

In a slow-growth economy, getting debts paid promptly and agreeing reasonable payment terms remains critical for all businesses in all sectors. Increasing numbers are turning to alternative options such as asset based finance as an innovative solution. More and more companies are recognising that discounting arrangements such as factoring or invoice financing could be a suitable way to unlock the value of their unpaid invoices or borrow against the value of assets to free up cashflow and give the go-ahead on vital capital investment.

To investigate how widespread the issue of late payment is and to find out which sectors are most adversely affected, and where the gaps are widening, we have conducted an in-depth analysis of data from Companies House covering almost 250,000 companies across a broad spectrum of industries.

This White Paper sets out our findings, which reveal some fascinating insights into where the improvements are being made, and where the problem is getting worse - information which should help to inform and shape policy on tackling the problem going forward.

About the ABFA

The ABFA represents the asset based finance industry in the United Kingdom and the Republic of Ireland. Its Members include the UK and Irish high street banks, specialist and challenger banks, the specialist businesses of some international banks and large corporates, and a number of independent non-bank finance providers. The ABFA is a source of information for those wanting to know more about the industry's products and services.

In addition, in 2013, the ABFA established a self-regulatory Standards Framework for its Members and their client. This Framework incorporates: the ABFA Code and supporting Guidance, setting out the standards which clients and potential clients can expect from ABFA Members; an independent Complaints Process delivered by Ombudsman Services; and an independent Professional Standards Council. Further information about this Framework can be found at: www.abfa.org.uk/standards.

About Asset Based Finance

There are two basic types of asset based finance.

Invoice Finance: The two main types of invoice finance are factoring and invoice discounting. Both allow businesses to release the working capital tied up in their unpaid invoices. In both the finance provider will normally purchase the client's outstanding invoices, providing an immediate initial payment of the majority of the invoice, with the remainder (less the financier's fees) paid to the client on payment by the debtor. Factoring incorporates an added service element, with the financier normally managing the credit control and collections process. This makes it particularly suitable for smaller businesses. In an invoice discounting facility the client would normally manage its own credit control. The majority of the funding currently provided by the industry in the UK and Ireland is through invoice finance facilities.

Asset Based Lending: An asset based lending facility will provide a broader mix of funding including revolving and amortising structures against the entire range of business assets. Traditionally advances are available against debts, inventory, real property, plant and machinery, but can be arranged against intangible assets such as brands and forward income streams.

Executive summary

Key findings of our research into the issue of late payment in the UK include:

- The typical time a UK business has to wait for invoices to be paid has risen by one day in just the last year – 61 days (nearly 9 weeks) is now the average, up from 60 days last year

- Smaller businesses continue to be hardest hit, with the gap between the smallest and largest companies widening. The smallest companies are now waiting 71 days (one day more than last year) – 33 days (or nearly 5 weeks) longer than the largest businesses

- The largest businesses are getting paid in 38 days – one day quicker than last year

- Property-related businesses are some of the worst affected, with estate agents and property management firms topping the list of sectors seeing the longest waits for payment – 112 days (16 weeks) is now typical

- Construction firms follow close behind, and have also seen the largest increases in payment delays – up by almost a quarter (22%) in a year to 82 days (compared to 67 last year). Given that supply chains in this sector are particularly long, this is likely to have a major knock-on effect on many other businesses

- Law firms and accountants face the third longest delays (77 days) – despite a marked improvement on last year when the average was 82 days – the biggest reduction of any sector. Concerted efforts to reduce waiting times appear to be working but there is clearly still further to go

- Farmers saw one of the top three biggest increases in payment waits– up 14% in one year to 58 days, from 51 the year before, putting capex on vital machinery at risk

- Manufacturers are heavily represented in the top ten sectors suffering from the longest payment delays, with manufacturers of general machinery and equipment – from engines to tractors to tools waiting 72 days

- However, some manufacturers are bucking the trend, managing to bring payment times down quite substantially – for example, clothing and furniture manufacturers

- The catering and hospitality industry is seeing invoices paid most promptly. Restaurants & bars receive payment in just 21 days while for hotels it is 23 days, although for both this has increased by a day since last year

- Road and trail transport companies have seen the number of days they must wait for payment decrease in the last year to 52 days (a drop of 2%, or one day), while air transport has seen one of the biggest increases waiting a whole week longer for payment (up 10% to 53 days)

Average payment times are getting longer – which sectors are the worst affected?

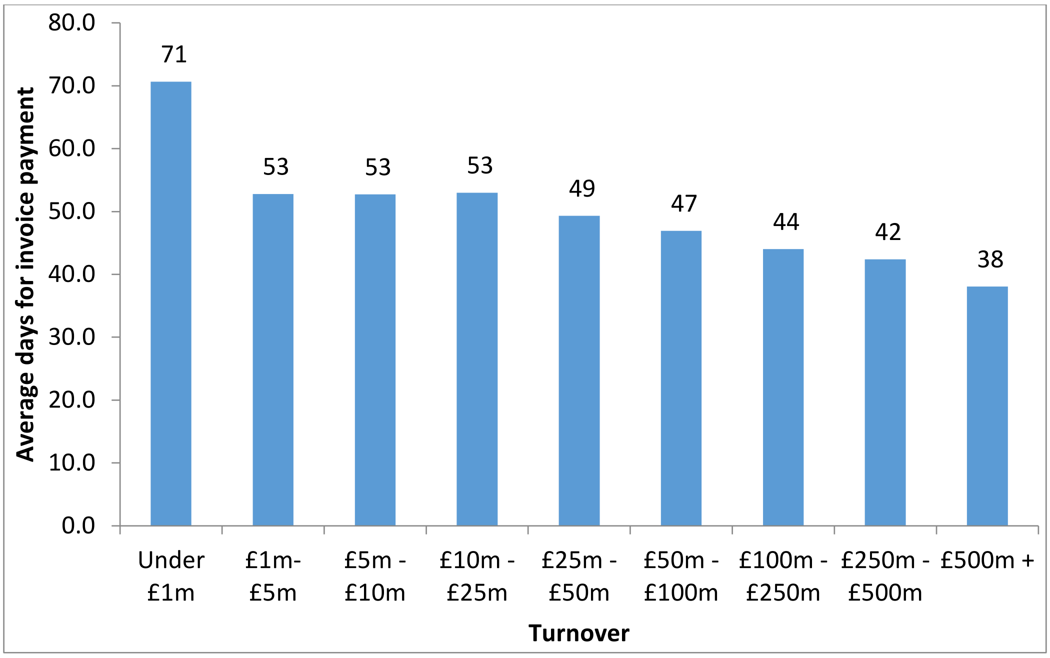
Obviously payment practices and culture vary between different sectors but what the data shows is that the waits for payment that became more common during the credit crunch are still continuing to worsen, with the average invoice taking 1 day longer to be paid than a year ago. This might not appear significant, but this is continuing an upward trend that has been occurring for some years and with delays of 61 days now typical, this is putting significant strain on businesses across the supply chain.

This means that UK businesses are now routinely waiting nearly 9 weeks for a single invoice to be paid.

But which sectors are suffering the worst delays, and where is the situation deteriorating fastest?
Can they learn anything from sectors where payment delays are shortening? In order to find out, we have conducted a sector-by-sector analysis, which has revealed some useful findings outlined below.

Gap between smallest and largest businesses widening considerably

Smallest businesses wait over a month longer for payment than largest companies



Our findings reveal that the gap between the smallest and largest companies is widening considerably.

SMEs with less than £1million in turnover are having to wait 71 days on average to be paid – over a month longer than the largest companies who wait 38 days.

Indeed, while payment delays for the smallest firms are one day longer than last year, large businesses with turnovers in excess of £500million are being paid on average one day faster than they were a year ago, when the average time taken for them to be paid was 39 days.

This growing gap between payment delays experienced by the largest and smallest UK businesses comes despite measures such as 2013's Late Payment of Commercial Debts Act, which enable SMEs to charge interest on late payments. However, many remain reluctant to do so, conscious of the adverse impact this could have on future business relationships.

It is clear that the burden continues to fall on those least able to bear the financial strain – making alternative options such as asset based finance a particularly helpful solution.

Table 1: Top 10 sectors with longest debtor days

Industry	**Debtor days - 1 year ago**	**2016 Debtor days**
Estate agents/property management companies	113	112
Construction main contractors (Builders)	67	82
Law firms and accountants	82	77
Advertisers and market research companies	78	76
Film, TV and music production companies	67	76
Printers (including newspapers) and companies that reproduce recorded media	75	73
Scientific research and development firms	75	72
Manufacturers of machinery and equipment (general)	71	72
Manufacturers of computer and electronic products	70	71
Manufacturers of electrical equipment	69	71

Property and construction businesses suffering longest waits for payment…

Many businesses in the real estate and construction sectors are still experiencing the longest waits for payment of any sectors.

Estate agents and property management firms are by far the worst affected, with average delays of 112 days (over 22 weeks), a marginal decrease of 1 day since last year notwithstanding. With every invoice taking around five months or more to be paid, the pressure on the sector's finances remains relentless.

In the construction sector, the problem has suddenly become far more acute, putting builders at number two on the list of sectors suffering the worst payment delays and top of the table of those experiencing the biggest increases. Builders have seen a painful 22% jump in payment delays – or 15 extra days - within the space of one year. They are now waiting 82 days for invoices to be paid, over 16 weeks.

In an industry with such high materials and labour costs, that additional three week wait is likely to be keenly felt. However, it is not just building contractors who are likely to suffer, but also their suppliers, as some businesses may be forced to delay paying their invoices until their own bills are paid – hitting the entire supply chain.

Table 2: Top 10 sectors seeing biggest year-on-year increases

Industry	Debtor days 1 year ago	2016 Debtor days	% change
Construction main contractors (Builders)	67	82	22%
Vets	21	26	24%
Farmers	51	58	14%
Film and TV production companies, including sound recording and music publishing	67	76	13%
Social work (excluding care homes)	26	29	12%
Sports, leisure and recreation activities	35	40	14%
Vehicle showrooms (wholesale and retail) and garages	28	31	11%
Education	25	28	12%
Air transport businesses	48	53	10%
Renting & leasing including vehicles, equipment & machinery	64	70	9%
Total	**60**	**61**	**2%**

…but architects and engineers see debtor days falling

In contrast to building firms, architects and engineers have seen the amount of time they typically have to wait for payment falling by two days – although delays are still relatively lengthy. Civil engineers can now expect to wait 64 days, while for architects and engineering designers 66 days is the norm.

Some specialist construction activities, including skilled trades such as plumbing, are also enjoying a slight improvement, with a 57-day average waiting time, compared to 58 last year.

It seems that those with specialist expertise, and particularly those at the front-end of the construction design process, are better placed to take steps to shield themselves from poor payment practices than main contractors themselves, or their suppliers.

Table 3: Top 10 sectors seeing a decrease in debtor days

Industry	Debtor days 1 year ago	2016 Debtor days	% change
Law firms and accountants	82	77	-6%
Furniture manufacturers	52	50	-4%
Civil engineering	66	64	-3%
Clothing manufacturers	54	52	-4%
Scientific research and development companies	75	72	-4%
Manufacturers of chemicals and chemical products	63	61	-3%
Suppliers of electricity, gas and air conditioning	51	50	-2%
Architectural and engineering services	68	66	-3%
Land transport companies	53	52	-2%
Specialised construction firms (e.g. roofers, plumbers)	58	57	-2%

Lawyers and accountants see fastest fall in payment times –however delays remain lengthy

Professional services firms have for some time been more affected by payment delays than many other sectors – and this remains the case today despite hard work by many firms to reduce waiting times.

Law firms and accountancy practices top the table of sectors which have seen the biggest decreases in payment times – which are down 6% in a year to 77 days (compared to 82). Despite this significant drop, this means they are still waiting an average of 15 weeks – putting them in the top three sectors with the longest payment times.

Investment in improved client management systems and credit control processes are starting to pay off, but there is still some way further to go for firms to get the number of 'debtor days' down to more manageable levels. Increasingly law firms and accountants are having to think 'outside the box' to bridge the gap and are more prepared to consider less 'traditional' financing options.

Manufacturing features heavily in Top 10 sectors with longest payment times…

The manufacturing industry is heavily represented in the top ten sectors suffering from the longest payment delays (see table 1).

Manufacturers of machinery and equipment – which covers a broad range of products from tractors to tools, engines to ovens – are now waiting an average of 72 days (14 weeks) up from 71 last year. Manufacturers of computers and electronic products and electrical equipment manufacturers wait 71 days.

In a sector whose competitiveness relies on its ability to regularly upgrade its machinery and equipment and to invest in cutting edge technologies in order to continuously improve quality and cut production costs, finding ways to access working capital for investment is vital. In an environment where banks' ability to lend remains constrained, alternative options such as asset based lending are increasingly filling the gap.

However, some manufacturing sub-sectors are bucking the long-delay trend, with clothing and furniture manufacturers among those seeing payment times fall in the last year (see table 3).

Catering and hospitality industry least affected by payment delays

The catering and hospitality industry enjoys the promptest payment of invoices. Restaurants & bars receive payment in just 21 days on average while for hotels and other types of guest accommodation it is 23 days, although in both cases this is up by a day since last year.

This is perhaps unsurprising for a sector where upfront payments in full or advance deposits are more common, lessening the need for retrospective invoicing. The comparatively swift payment times suggest that where after-the-event invoices are issued, these kinds of businesses are enforcing payment terms relatively robustly.

The continued popularity of these sectors, particularly with rising disposable incomes across the UK, may have given these businesses the security and confidence to impose payment terms on customers more proactively than some other sectors.

Table 4: Sectors with the shortest waits for payment

Industry	Debtor days 1 year ago	2016 Debtor days
Restaurants, caterers and bars	20	21
Hotels and guest accommodation	22	23
Residential care homes	23	24
Vets	21	26
Education	25	28
Social work (excluding care homes)	26	29
Vehicle showrooms (wholesale and retail) and garages	28	31
Retailers (excluding motor vehicles)	30	32
Healthcare	38	39
Sports, leisure and recreation activities	35	40

Conclusion

It's clear from our analysis that lengthy payment delays are still very much an issue for businesses across many industries, despite various well-meaning initiatives to tackle late payment and poor payment practices. Payment times vary greatly, with the worst affected sectors waiting more than five times longer than those with the shortest payment times.

Small businesses in particular remain reluctant to put valuable customer relationships at risk by exercising their relatively new rights to levy interest on late payments. Initiatives like the Prompt Payment Code, though laudable in ensuring big businesses pledge to pay suppliers more quickly, do not appear to be having a significant impact on bringing debtor days down for smaller suppliers.

There are some bigger tools available as well. The new Department for Business, Energy and Industrial Strategy is expected to shortly bring forward long-awaited legislation to outlaw the practice of large businesses blocking their smaller suppliers accessing finance through the use of so-called 'ban on assignment' clauses.

Such bans are an unacceptable imposition on smaller businesses that unfairly restrict their ability to use their own assets (the funds owed by its customers) to access finance; action against them is long overdue and will at last bring the UK into line with the US, Canada, Australia, New Zealand, most of Europe and many other legal jurisdictions around the world.

This is a policy that enjoyed widespread stakeholder and political support when the Small Business Act went through Parliament last year and bringing the implementing Regulations into force as soon as possible will be a real boost for small businesses. It will not solve the problem of poor payment practices but it will enable more small businesses access to the kinds of financing tools that will help them manage their cash-flow more sustainably and bridge the gap between doing the work and getting paid for it.

The Government has demonstrated its seriousness in tackling the issue of late payment by announcing that the new Small Business Commissioner will have the remit of addressing payment delays to SMEs. However it remains to be seen how much impact this will have; the ABFA is calling for an empowered Small Business Commissioner with the profile, status and resources to make authoritative recommendations or directions to Ministers on the full range of issues that matter small businesses.

We believe that the Commissioner should be given the powers to report on 'letter and spirit' compliance with legislation and its formal powers should be complemented by a clear mandate and a range of softer powers to identify and encourage good practice and to call out bad - the Groceries Code Adjudicator has demonstrated that behavioural change is possible.

While some sectors have seen significant improvements, the issue remains critical in spite of improving economic conditions we have seen in the last few years. As UK plc enters a new period of economic uncertainty decisive action is still required.

While policymakers continue to grapple with this issue, solutions are already available. Asset based finance can be a means by which businesses access the value of their unpaid invoices or other assets to enable them to plan for the future and invest for growth, without being hamstrung by the heel-dragging of others.